



## WHY SMALL CAPS?

There is ample evidence that small caps in most global markets outperform large cap stocks. Indeed Australia is one of the only small cap indices to actually under perform the large cap index. Why is this so? Without doing the required research we would guess it's the destruction of so many mining/exploration and mining services stock's share prices in the last few years.

Having acknowledged this index under-performance, what is interesting is that small cap focussed fund managers have out performed both the small cap index and the large cap index.

		Australian large cap 5yrs	Australian large cap 10yrs	Australian small cap 5yrs	Australian small cap 10yrs
Index return		12.3	9.4	5.8	4.9
Fund returns	75 <sup>th</sup> percentile	14.3	11.3	19.4	13.6
	50 <sup>th</sup> percentile	13.1	10.6	16.5	11.7
	25 <sup>th</sup> percentile	12.2	9.9	15.1	11.3

Annual index outperformance by median fund		0.8	1.2	10.7	6.8
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The graph above is a comparison of funds vs. Index returns for Australian Large and Small Cap fund managers (% p/a source: Morningstar April 2014)

Not only has the median small cap fund significantly outperformed the small cap index over 5 and 10 years periods (10.7% and 6.8% respectively), the bottom quartile small cap fund (15.1% p/a) has outperformed the top quartile large cap fund (14.3% p/a) when measured over 5years. This is despite the fact the small cap index under performed its large cap rival.

**This supports our very strong view that the small cap end of the market is significantly cheaper and less efficient providing better absolute value and more “compelling” opportunities than the better researched large cap end of the market.**

**We are far more likely to find “pineapples” (see investment process for more info) at this end of the market providing lower risk and higher potential upside.**

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